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COUNTRY AND REGIONAL EXPERIENCES IN ATTRACTING FOREIGN DIRECT INVESTMENT FOR DEVELOPMENT

Exchange of information on foreign direct investment

Report by the UNCTAD secretariat

SUMMARY

This report reviews briefly ongoing efforts regarding intergovernmental exchanges of information and experiences in dealing with foreign direct investment. Since these exchanges indicate that host countries are concentrating a good part of their policy efforts on the liberalization of their foreign-direct-investment regimes to attract foreign investors, the main body of this report examines the liberalization process. Firstly, it analyses it from a conceptual perspective, defining it as consisting of the elimination of restrictions and discrimination, the establishment of positive standards and the introduction, where need arises, of certain controls to ensure the proper functioning of markets. Liberalization is distinguished from other types of measures also aimed at attracting foreign investors and the broader regulatory context, while noting the interrelations between various policy measures. Secondly, the main trends and recent changes in policy measures regarding foreign direct investment are summarized to indicate how far the liberalization process has gone and what restrictions remain and why they are maintained. A summary appraisal of the main policy changes shows that unilateral efforts towards liberalizing national foreign-direct-investment regimes has brought about a remarkable level of convergence, despite the very few multilateral commitments that exist in this area. But liberalization measures alone are not sufficient to provide a favourable investment climate.

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Such measures need to be complemented with an appropriate basic legal framework, functioning legal and administrative infrastructures and with promotional activities. Taken together, these elements create a climate conducive to foreign direct investment. Lastly, the report underlines the importance of providing transparency of foreign-direct-investment regulatory frameworks through the international exchange of views and experiences.

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INTRODUCTION

1. In its resolution 1993/49, paragraph 18, the Economic and Social Council called upon Member States to exchange information among themselves, their interested private sectors and all competent organs, organizations and bodies of the United Nations system on their activities, programmes and experiences related to the promotion of foreign direct investment (FDI), in particular in developing countries. In addition, the Council requested the Secretary-General to prepare, as part of the documentation for the twentieth session of the Commission, a report on exchange of information on FDI. The present report has been prepared by the Programme on Transnational Corporations in response to that request.

2. Section I of the report reviews briefly the exchange of experiences on FDI by the Commission on Transnational Corporations, by UNCTAD's Ad Hoc Working Group on Investment and Financial Flows, and by the Organisation for Economic Cooperation and Development (OECD) among its member countries. Also relevant are the exchanges of experiences undertaken by UNCTAD's Ad Hoc Working Groups on Comparative Experiences with Privatization 1/ and Interrelationship between Investment and Technology Transfer. 2/ One of the principal themes emerging from these exchanges of information and experiences is the trend towards the liberalization of FDI regimes. Drawing on these experiences, section II analyses the process of liberalization of FDI policies from conceptual and empirical perspectives. Paragraphs 11 to 35 of that section examines the characteristics of the liberalization process in general and provides a conceptual framework for analysis, while paragraphs 36 to 59 - taking into account the discussions of the Ad Hoc Working Group on Investment and Financial Flows - assess how far the liberalization process has gone, what restrictions remain and why they are maintained. Section III outlines the importance of the broader context for policies on FDI. The report concludes with a note on the benefits of exchanges of experience and the increased transparency of investment policies associated with it.

I. EXCHANGE OF EXPERIENCES ON FOREIGN DIRECT INVESTMENT

3. Since FDI has become a principal topic in international economic relations and an important element of national and international development strategies, it has increasingly received attention by policy makers. Policies on FDI affect the overall level, sectoral composition and direction of capital flows and the trade, technology, training and financial flows associated with them, as well as the degree and type of production integration effected between countries. As a result, national FDI policies in one country can affect economic performance in other countries, especially given the role of transnational corporations (TNCs) as integrating agents of various international economic flows. This applies not only to host country policies but also to home country policies. Policy making in the area of FDI thus carries international, as well as national, implications.

4. One of the main tasks of the Commission on Transnational Corporations as the focal point within the United Nations system for all matters relating to foreign direct investment and transnational corporations has been to exchange

views among its member States on their experiences in dealing with FDI and TNCs. Such a dialogue in the Commission has helped to disseminate knowledge about the various policies and approaches of individual countries towards these corporations, and underscored the multiple interrelations of these policies with those in other countries. These discussions have helped to increase the level of convergence among national policies and normative frameworks. Furthermore, the exchange of information on national experiences with FDI has provided useful insights to both Governments and TNCs for the design of their policies and strategies.

5. The growing emphasis placed on FDI as an international policy issue is also reflected in the activities of UNCTAD's Ad Hoc Working Group on Investment and Financial Flows. While the focus of its discussions relating to FDI was on host country policies and measures to promote FDI, a wider range of issues was covered. The discussion on foreign investors' motivations benefited from the presence of non-governmental experts representing TNCs and academia. Home country studies were presented by the Netherlands, the Republic of Korea and the United States of America. 3/ These studies indicated measures being undertaken to encourage FDI in developing countries and countries in transition, such as the use of bilateral investment protection agreements, subsidies for feasibility studies and re-insurance of investment against political risks. On multilateral measures to promote FDI, representatives of the United Nations Industrial Development Organization (UNIDO), the World Bank and UNCTAD's Programme on Transnational Corporations presented their activities dealing with the provision of technical assistance and advisory services. The exchange of experiences on host country policies and measures to promote FDI was largely based on case studies presented to the Working Group by nine countries: Brazil, China, India, Mexico, Morocco, Myanmar, Nigeria, Philippines and Republic of Korea. 4/ These case-studies were prepared in accordance with a format suggested by the Ad Hoc Working Group's chairman, with the assistance of the UNCTAD secretariat. During the informal meetings, other countries provided an overview of their FDI policies. The discussion of policies was not limited to FDI-related measures but dealt also with the macro-economic policy framework, which has an important bearing on FDI flows and which represents an essential element in the creation of an enabling investment climate. The principal finding was that a widespread trend towards liberalization and market-oriented reform characterized economic policies, including FDI policies, since the 1980s. There was a high degree of policy convergence in terms of objectives, but variations existed in the pace, timing and degree of liberalization. The extensive discussions and exchanges of views in the Group have contributed to a better understanding of the issues relating to FDI and the motivations and concerns of the various actors involved, which is useful in policy formulation at both the national and international levels. 5/ The final report of the Ad Hoc Working Group will be made available to the Commission on Transnational Corporations. The report will contain the main findings and policy conclusions, as well as an assessment of the implementation of the work programme; it will also identify areas for further intergovernmental discussions and technical cooperation.

6. OECD, too, has considerable experience in the review of relevant country policies, beginning with reviews in the context of the codes dealing with the liberalization of capital movements and invisible transactions; the purpose of these reviews is to monitor compliance with the liberalization commitments

undertaken under the codes. (The codes cover most forms of FDI.) OECD has also reviewed country policies in connection with the national treatment instrument, with a view towards dismantling measures that are contrary to national treatment commitments, or to make these measures more transparent. Since 1991, the format of these reviews has changed. OECD now undertakes comprehensive reviews of the role of FDI in a country's economy and the country's policies on FDI, including sectoral restrictions, their interrelations with other aspects, such as trade. The reviews have helped to enhance the process of liberalization within the OECD area and contributed to a greater convergence of policies. They have also shown that there are many differences among OECD countries' policies, reflecting the different economic and social characteristics of individual countries, but also reflecting differing views and positions as to what types of measures and approaches to FDI are appropriate. Countries see in the review process an opportunity to explain their positions on FDI.

7. As the discussions in these bodies indicate, host countries are now concentrating a good part of their efforts on the liberalization of their FDI regimes, with a view towards attracting foreign investors. Where obstacles and disincentives once were the hallmarks of FDI rules, these have now been replaced by a series of measures aimed at removing such obstacles and disincentives and at placing foreign affiliates on a similar footing vis-à-vis national companies. 6/ Recent developments at the multilateral, regional and bilateral levels - for example, the conclusion of the Uruguay Round of multilateral trade negotiations (which includes agreements on international trade in services and trade-related investment measures), the ratification of the North American Free Trade Agreement (NAFTA), the efforts of OECD to formulate a wider investment instrument and the increasing number of bilateral investment treaties (United Nations Centre on Transnational Corporations, 1992; and UNCTAD Programme on Transnational Corporations, 1993) - are likely to add impetus to the process of liberalization of national frameworks already under way.

8. All these developments demonstrate that the trend towards liberalization of FDI policies is pervasive. It is - in its strength and depth - also relatively recent and has not yet been fully examined. There is still considerable uncertainty and confusion as to its actual character and contents. The next section of this report seeks therefore to clarify the meaning and distinguish the various elements that constitute the notion of liberalization of policies on FDI, before proceeding to examine how far the process has resulted in changed investment frameworks world wide. The precise impact of liberalization measures on FDI flows and their relative importance as compared to that of other factors and conditions in influencing such flows is a separate issue that is not addressed here. Moreover, specific policy conclusions - whether liberalization policies are to be recommended and, if so, under what conditions - can only be reached after examining their effects in concrete contexts. However, it can be expected that, to the extent that FDI frameworks become similar, specific differences that remain - everything else being equal - may influence decisions as to the location or expansion of investment projects.

II. THE PROCESS OF LIBERALIZING FOREIGN-DIRECT-INVESTMENT POLICIES

9. Since the early 1980s, more and more countries have changed their policies on FDI. 7/ Largely adopting a favourable approach towards FDI, they have sought to encourage and facilitate it and have undertaken to eliminate or temper restrictive policies and adhere to certain positive standards. This trend, widely known as "liberalization", has become more widespread during the early 1990s, as more developing countries and countries with economies in transition have joined in the process. Unilateral efforts 8/ towards the liberalization of national investment frameworks have led to remarkable similarities of investment policies and frameworks among countries from all regions (European Round Table of Industrialists, 1993 a and b). (But it has not let to a multilateral codification of what has been achieved so far, in an effort to provide the transparency and stability that is so important for a favourable investment climate.) Yet, the actual process of liberalization has been far from homogenous, and considerable differences remain in the nature, breadth and depth of the measures taken, reflecting different political, economic and social priorities, as well as different degrees in the decrease of state controls and planning and confidence in the ability of Governments to steer business processes. At the same time, this process is embedded in a broader liberalization trend concerning world trade and the transfer of technology, as well as progress regarding the strengthening of intellectual property protection. As in the case of trade, the establishment of a liberal framework for FDI, if properly undertaken, can be a process beneficial to the world economy as a whole, as well as to individual economies, to the extent that it encourages competitiveness and efficiency.

10. Thus, the process of liberalization of FDI policies needs to be seen as part of a broader process of liberalization of international markets and cross-border movements of factors of production that is taking place simultaneously - to a greater or lesser extent - in most parts of the world. It receives additional impetus from the emergence of an international integrated production system which increases the need for many TNCs to be able to integrate (horizontally and vertically) activities across borders. The complexity of creating a favourable climate for FDI operations by liberalizing FDI policies increase therefore.

A. Conceptual issues

1. Delimiting the notion of liberalization

11. A number of basic points must be made at the outset. The first one is implicit in the very term used, "liberalization process". The focus is on a process, not on a final or static situation. At the same time, one is not dealing with a mere continuum, a static line between two ideal ends, but with a dynamic process, a process that moves in a certain direction. A country's pertinent policies and measures at a particular point in time can therefore only be described in relative terms: they are more or less liberalized. As a result, the reference to a "liberalized regime" in what follows should be understood to mean, "reasonably liberalized", that is to say, a regime that has

gone a long enough way on the road to liberalization, so as to exhibit characteristics such as those to be enumerated.

12. The second point concerns the very meaning of liberalization in the area of FDI. According to common usage, this concept denotes the removal of restrictions on foreign investors and the decrease or elimination of measures tending to limit or condition the entry and operation of foreign enterprises. It is not impossible to operate throughout with such a negative approach to the notion of liberalization, describing all elements of the liberalization process in the area of FDI in terms of the removal of barriers, restrictions or discriminatory treatment. Despite its consistency, however, this approach is of limited usefulness because it treats in negative terms facets of the liberalization process that are normally understood as involving positive action regarding foreign investors. In particular, such key elements of the liberalization process as the grant of national treatment to TNCs and even the operation of a reasonably modern market-oriented legal system lose thereby something of their particular character and function. It is therefore useful for the purposes of this report to proceed on the basis of the view that an essential aspect of the liberalization process involves the adoption of, and adherence to, positive measures and standards.

13. Furthermore, the overall positive effect of the liberalization process depends to a considerable extent on the presence and, where necessary, the strengthening of controls aimed at ensuring the proper functioning of the market and at protecting broader economic and social concerns. For instance, rules to assure competition and prevent abuse of market power are an integral part of a reasonably liberalized investment regime, as is the existence of an adequate regime for the protection of intellectual property. Similarly, prudential supervision of certain activities such as banking and financial services is necessary to ensure the reliability, stability and safety of the national financial system. The need to have appropriate health, safety, environmental and consumer standards is another illustration of necessary controls. Further, disclosure of information becomes more important for Governments, consumers and other groups since they have to be able to act in an informed manner. While meant to facilitate the function of the market, laws and regulations in these and other areas provide the framework within which enterprises conduct their affairs. To understand properly the liberalization process, therefore, one must determine not only its principal elements but also the kinds of legal and policy controls that are compatible with it, or indeed may be conditions for it.

14. The third initial point is that a clear distinction must be drawn between policies aimed at liberalizing FDI and policies aimed at creating a favourable investment climate and, especially, attracting or promoting FDI. The distinction is not an easy one in practice. The two types of policy complexes are closely linked in a means-to-end relationship: a principal aim of current liberalization measures is to attract FDI. Liberalization however is not the only possible method to attract FDI, nor is it necessarily the most effective one under all conditions. In the past (and, in many cases, still today), a variety of restrictive measures (typically, tariff protection) has been used in order to attract FDI. In fact, favouring FDI can be as interventionist a policy as regulating it - as, for instance, in the case of incentives and privileges offered selectively to TNCs.

15. A further difficulty in distinguishing the two policy complexes lies in the fact that, in addition to removing obstacles and restrictions to FDI, and to private investment in general, liberalization also includes a number of measures that are specifically addressed to FDI and reflect its special characteristics and peculiarities (e.g., special provisions for the free transfer of funds outside a host country).

16. In sum, a working definition of the liberalization process includes the tempering or elimination of restrictions on FDI by Governments, their adherence to certain positive standards of (equal) treatment and protection and the introduction of certain controls and prudential supervision to ensure the proper functioning of the market (figure 1). The present discussion starts therefore with the negative, the restrictions to be eliminated or tempered, and then proceeds to the positive traits and features of a liberalizing FDI regime, to conclude with a summary appraisal.

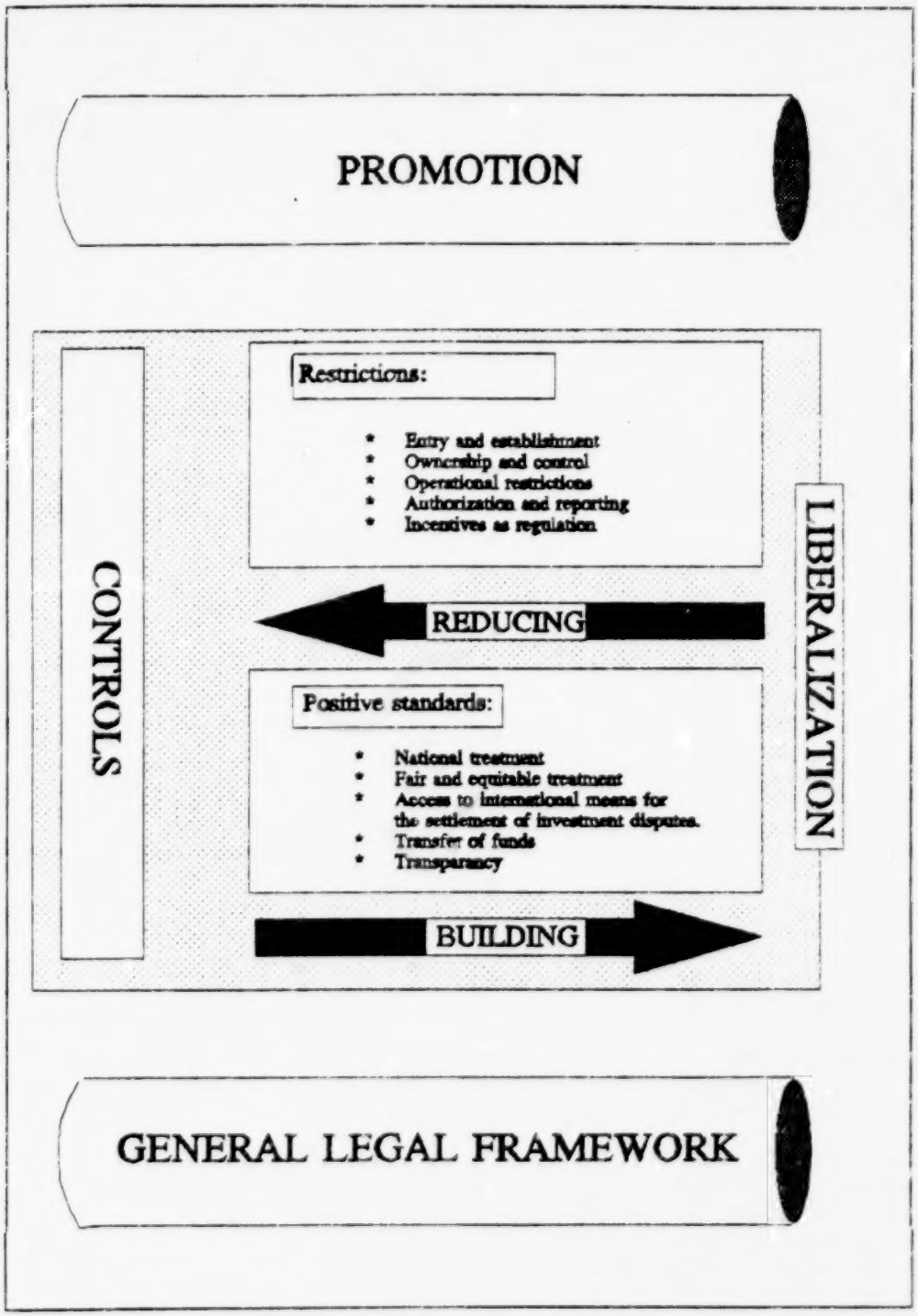


Figure 1. Main elements of the investment climate

2. Removal of restrictions

17. Any classification of restrictions on FDI is to some extent arbitrary, since fully consistent criteria cannot be found. Particular measures and policies usually have more than one purpose or effect, so that significant overlaps between categories cannot be avoided. All that can be attempted here is to review a number of policies and measures that are of importance, with an emphasis on their rationale and function.

(a) Entry and establishment

18. A first category of restrictions whose elimination is the hallmark of a liberalized FDI regime is that of restrictions on entry and establishment of FDI. Such restrictions generally seek either to limit FDI or to channel it and to determine or affect its likely effects, with a view to ensuring that the economy and/or its most important sectors are not dominated by foreign affiliates. The underlying rationale is the desire to keep in the hands of nationals of the host country the principal benefits from FDI, as well as decision-making control concerning the country's economic activity and growth. Foreign affiliates are assumed to be less likely to act in response to considerations of host country national interest and to be less subject to national governmental or political influence or control. (Proponents of liberalization challenge, of course, both the validity of such assumptions and the desirability of ensuring a degree of national control.)

19. The explicit purposes of such restrictions vary. One major category is the protection of national security, public order and vital national interests. These considerations tend to be regarded as natural exceptions to the general principles of liberalization and, as such, it is unlikely that they will disappear in the foreseeable future. Since, in the absence of an international framework on FDI, the determination of what constitutes a matter of public order or a threat to national security and vital national interests is left to the discretion of the host country, such considerations may be interpreted narrowly or more broadly. As this is the most widely accepted and the most "respectable" ground for restrictions on FDI, host countries may sometimes invoke it in order to exclude investments not wanted on other grounds. Restrictions on entry may also be directed at specific countries, as part of policies adopted for political reasons. The economic and social objectives of the host country are another major category of purposes served by such restrictions. In developing countries, in particular, restrictions on FDI are often used to promote specific development objectives; although there may be conflicts between particular objectives and economic policies, restrictive or otherwise, they generally have to meet criteria of economic efficiency. 9/

20. The case of policies and measures intended to keep FDI out of a country altogether is hardly real any more today. Restrictions on entry are generally partial. Restrictive measures are intended either to exclude or limit FDI from specific economic sectors, industries or activities, or to determine specific characteristics or effects of investments. Such restrictions tend to be justified on the basis of the strategic importance of the sectors involved for the host economy or, sometimes, with reference to particular industries or geographical locations, on national security grounds.

(b) Ownership and control

21. A second category or form of restriction affecting FDI are ownership requirements, especially limitations on the percentage of equity that foreign investors are permitted to own in local enterprises (in all sectors or more often in specified industries or activities) or requirements of local participation in the management of an enterprise (e.g., creation of joint ventures). A variety of methods have been used to ensure local participation in the internal decision-making of foreign affiliates.

22. Other restrictions of a similar character may also be imposed. Fade-out (disinvestment) requirements and requirements concerning the reinvestment of profits fall essentially in the same general category of direct restrictions on FDI, although they are no longer in use.

(c) Operational restrictions

23. Restrictions may also be imposed on a foreign affiliate concerning its operations after it has been established. Their purpose is to increase the benefits to be derived by the local economy from the operation of a foreign affiliate and to determine in specific terms some of the precise effects of such operation.

24. Such requirements may involve limitations on the employment of foreign managerial, technical or (less frequently) other types of personnel, priority employment of local labour and, in some instances, restrictions on access to local raw materials and supplies. They may also involve the imposition of performance requirements aimed at the promotion of exports, import substitution or the encouragement of local production (e.g., through local content requirements). Such requirements may be imposed at the time of entry as a condition for allowing the investment, or they may, more often, be linked to the offer of positive inducements, such as tax incentives. They had recently become more common, as substitutes for more rigid entry requirements, although, to the extent they may adversely affect foreign trade, they are, after the Uruguay Round agreement on trade-related investment measures, subject to international disciplines.

(d) Authorization and reporting

25. A fourth category or measures, whose restrictive effect depends on several factors, is those concerning authorization, registration or reporting in connection with various aspects of an investment. Certain distinctions must be made in this connection:

(a) Restrictions on entry and ownership may be applied on the basis of a screening process, a procedure whereby an investor's projects are assessed by the competent government agency in order to grant or deny authorization to invest;

(b) Authorizations and permits may also be needed for a variety of other purposes of varying importance, such as transfer of technology, importation or exportation, or to operate in certain activities;

(c) Registration or reporting are in principle less restrictive measures than authorization. They may be intended to enhance transparency, for general purposes (e.g., statistics) or in order to cope with certain aspects or effects of an investment, for instance, when seeking to determine the amount of funds (revenues or capital) that foreign investors will be entitled to transfer outside the country, or, of course, in response to environmental or consumer-protection concerns.

26. The actual restrictive effect of reporting requirements depends in large part on the mode of operation and the efficiency of the host count y's public administration. When coupled with express or implied requirements of authorization, they may have a definite restrictive effect, often depending on the degree of discretion allowed to the pertinent authorities. Yet, even where they involve solely the provision of information (solely for purposes of transparency), bureaucratic requirements and procedures may bring about delays and other restrictive effects.

(e) Incentives as regulation

27. A fifth category of regulatory and sometimes restrictive measures consists of tax or other incentives designed to attract and encourage FDI. Evidently, such measures are intended to favour and attract rather than limit FDI and they differ significantly from those mentioned earlier. (Where such incentives are not available to local firms, furthermore, they effectively discriminate against them.) Yet they frequently have in fact definite restrictive effects. They are generally offered only to enterprises meeting certain conditions. They therefore require application or screening procedures and may be used (as they often have been in the past) in return for performance requirements or as an indirect means for regulating or channelling FDI: foreign investors may nominally be allowed to invest freely in the country concerned, but investors that meet additional conditions, frequently quite similar to the conditions on entry and ownership mentioned above, are subject to various kinds of approvals, granted special treatment - tax concessions and deferrals, exemptions from customs duties, guaranteed free transfer of funds, guarantees against unfavourable treatment (e.g., expropriation). Where such incentive systems exist, foreign investors generally prefer to use them and avoid taking the simpler but less attractive route of free entry, without special promises. Regulation through the offer and administration of incentives may be an effective substitute for direct controls over FDI. Although it is possible to establish incentive schemes with minimal regulatory (and restrictive) effects, such practices have not in fact been much in use in the recent past. It should be recalled, on the other hand, that whether tax and other incentives are successful and effective in attracting FDI is a matter of much debate.

28. As already mentioned, in a liberalized FDI regime, the restrictions and discriminations listed are tempered or eliminated, but the process should not be measured in simple arithmetical terms. In other words, the real outcome cannot be found through mere catalogues or simple calculations: which and how many restrictions have been eliminated, now many still remain. The relative importance of the various measures enumerated differs widely depending on the broader legal and economic framework and the quality of public administration of the country concerned. Moreover, the situation may vary significantly between

economic sectors. Restrictions may persist in certain sectors while others may be fully liberalized.

3. The role of positive standards

29. Most of the restrictive policies and measures listed above may be addressed solely to foreign investors, whether defined in terms of the nationality of the investors and enterprises involved or in terms of the origin of the capital. Some measures, e.g., entry requirements, are almost necessarily so addressed. In other cases, however, both foreign and domestic investors may be affected; for instance, certain sectors may be closed to all private investment, reporting may be required of all investors, export requirements may be imposed on all. While equality of treatment as between domestic and foreign investors - that is to say, for most purposes, the standard of national treatment - is undoubtedly a very significant part of the liberalization process, it does not exhaust the process. The two notions are not synonymous.

(a) National treatment

30. The granting of equality in the treatment of nationals and aliens, especially foreign affiliates, i.e., the national treatment standard, is an indispensable element of the liberalization process. While there are variations in the formulation of the standard in specific instruments, 10/ the basic concept of national treatment is that, in principle, foreign affiliates and domestic firms in similar situations should receive the same treatment, regarding such things as establishment, ownership and control of enterprises, full access to courts and other authorities and equal protection under the law, as well as taxation, labour law, consumer protection or protection of the environment, not to mention free access to credit facilities, or even government aid to enterprises (box 1.). Such a listing covers most of what is usually meant by liberalization. Restrictive measures such as limiting the access of aliens and foreign affiliates to legal process, imposing burdensome requirements for the recognition of foreign companies, denying aliens the right to hold real property, and others have sometimes been left over from much earlier times, when the law treated aliens and foreign companies with a high degree of distrust. In other instances, probably a minority by now, they reflect the same effort to limit and control foreign investments that other measures described here also involve.

31. However, equality of treatment with host country nationals and companies may not, in a number of cases, address pertinent problems adequately, especially where the objective situation of foreign investors is significantly different from that of domestic actors, as is the case in the transfer of funds abroad. The measures needed in such cases have to move beyond mere equality of treatment, although they are generally understood as covered by the notion of liberalization. Traditional, formal definitions of national treatment take care of most such problems by limiting application of the standard to "like situations" and by formulating the standard in terms of treatment "not less favourable than" that of nationals.

Box 1. National treatment as defined in the General Agreement on Trade in Services of the Uruguay Round of Multilateral Trade Negotiations

One of the most recent formulations of the standard of national treatment in a multilateral instrument relating to FDI is that contained in Article XVII of the General Agreement on Trade in Services (December 1993) which was approved by consensus. Article XVII states,

> "1. In the sectors inscribed in its schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.
>
> 2. A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service providers.
>
> 3. Formally identical and formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or services providers of any other Member." a/

a/ GATT Secretariat, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, MTN/FA, 15 December 1993.

32. Such issues raise important conceptual and practical problems. This is particularly true of the free-transfer-of-funds requirement. Where they still exist, exchange restrictions are general in character, that is to say, they apply to local as well as foreign enterprises. No formal discrimination against foreign investors is then necessarily involved in their application. A liberalization of FDI policies, however, is usually understood to cover the elimination of exchange restrictions to the extent that they affect foreign investment, on the not unreasonable ground that, generally speaking, the conditions of local and foreign investors and enterprises are significantly different with respect to questions of foreign exchange and funds outside the host country. For one, the headquarters, or profit centres, of local firms are by definition in the host country. At the same time, provision for the free transfer of funds means in reality, at least in principle, a guarantee to that effect. The host government undertakes not merely to allow investors to find foreign exchange, but to ensure that they find it. Moreover, procedural and other requirements, including the need for general or ad hoc authorizations and permits, generally intervene in the administration of such measures, so that in practice it is sometimes hard to distinguish between measures favouring (or privileging) investors and restricting them.

33. Other cases in the same broad category may be more controversial. For instance, in recent years the argument is increasingly advanced that, on lines essentially similar to those just mentioned (i.e., the specific character and needs of FDI), foreign affiliates should have free access to international arbitration for the settlement of any disputes between them and the host state, over and above the access to the local judicial and administrative machinery which they may have through the operation of a generalized national treatment principle. The specificities of FDI to which this claim corresponds are usually not spelled out in any detail. They may be understood to refer, on the one hand, to the likelihood that local courts and tribunals may lack the specialized competence in modern business law issues that an arbitration tribunal may provide and, on the other, to the fact that, since the investors are not nationals of the host country, they do not normally participate in national political processes and are more likely to be discriminated against by national authorities and tribunals. At any rate, provisions on international arbitration on FDI matters, whether under the auspices of the International Centre for the Settlement of Investment Disputes (ICSID) or otherwise, have found their way in numerous bilateral and multilateral agreements, so that the practice is becoming established and is reaching the point when it will be beyond theoretical argumentation.

34. Similarly, a foreign investor's access to a host country's legal process and to legal protection, part and parcel of national treatment as well as of liberalization, is in many instances strengthened by corresponding undertakings at the international level. To the extent that the (mostly conventional) international legal norms and concepts that have been developed, such as fair and equitable treatment, are now adopted in national legislation as well, it would appear that specific standards of legal protection, stronger or more specific than those applicable to nationals, are emerging.

(b) Transparency of laws, regulations and administrative practices

35. The effective functioning of the liberalization process requires that reliable information about FDI policies and practices be available. Transparency relates to the need for disclosure and clarity of all government measures that affect the operation of foreign affiliates in a host country. In that sense, transparency involves the publication within a host country of relevant measures in whatever formal manner is provided by national law, and they are to be made available to interested persons within the bounds of the customs and practices prevalent in the country concerned. A gradual approach to the achievement of transparency would involve the elimination of deliberate administrative obfuscation and secretiveness. A system of formal publication of laws and regulations is also important. Notification or other special forms of publication may be feasible only with respect to limited, precisely defined issues and types of measures.

B. Country experiences with liberalization

36. A detailed survey of the current situation with respect to normative frameworks on FDI is not undertaken here. Yet, drawing partly on the results of the country studies submitted to the Ad Hoc Intergovernmental Working Group on

Investment and Financial Flows, 11/ and on surveys and a review of other pertinent data (European Round Table of Industrialists, 1993b; United Nations Centre on Transnational Corporations (UNCTC), 1992a, 1992b, 1993; UNCTAD, 1994a, 1994b; Office of the United States Trade Representative, 1992; World Bank, 1992; OECD, 1992 and 1993), it is possible to provide a reasonably faithful summary account of the extent to which the liberalization process has gone today, starting with the elimination or decrease of restrictions and moving to the establishment of positive standards (tables 1 and 2).

Table 1. Standards of treatment for foreign direct investment in bilateral investment treaties,[a] December 1991

Standard	Number of countries, by region, that provide the standard				
	Africa	Asia and Middle East	Latin America and Caribbean	Eastern Europe	Western Europe
1. **Admission**					
a) In accordance with legislation, regulations, administrative practices and economic policies	62	65	25	19	5
b) Endeavour to admit in accordance with the laws (regulations)	0	9	0	0	0
c) In accordance with national treatment / most-favoured-nation treatment standards	2	1	3	0	0
d) No admission clause	27	16	2	7	6
2. **Treatment**					
a) Fair and equitable treatment	93	81	30	26	8
b) National treatment (and fair and equitable treatment)	8	1	0	0	0
c) Most-favoured-nation treatment (and fair and equitable treatment)	59	60	2	30	2
d) National treatment (and most-favoured-nation treatment)	141	78	52	15	13
e) Treatment not to privileges granted on basis of customs union, taxation treaty, etc	53	51	22	19	10
3. **Transfer of capital and return of funds**					
a) Without delay	99	84	29	28	9
b) Installments	16	9	12	4	2
c) Interest for delay	6	5	4	6	1
d) Rate of exchange official / market	20	30	16	18	3
4. **Settlement of disputes**					
a) Arbitration clause	99	87	30	22	9
b) Reference to ICSID	45	53	21	15	3
c) No arbitration clause	1	0	0	0	0

Source: Based on a survey of 253 bilateral treaties conducted by the World Bank, Legal Framework for the Treatment of Foreign Investment, volume I, Survey of Existing Instruments (Washington D.C., The World Bank Group, 1992).

[a] Bilateral investment treaties conducted with the following OECD countries: Belgium and Luxembourg, Denmark, France, Germany, Netherlands, Norway, Sweden, Switzerland, United Kingdom and United States.

Table 2. Standards of treatment for foreign investors in selected national investment codes, December 1991

Standard	Number of countries, by region, that provide the standard			
	Africa	Asia	Latin America and the Caribbean	Central and Eastern Europe
1. Admission				
a) Authorization required	10	8	5	4
b) No special restrictions for entry	16	1	2	1
2. General standards of treatment				
a) National treatment	18	2	4	4
b) Fair and equitable treatment	1	2	0	0
c) No provision	7	5	3	1
3. Transfer of capital and profits				
a) Unconditional transfer	1	0	0	1
b) Transfer subject to regulations	20	3	4	3
c) Transfer subject to regulations and installments on liquidation or only after a specified period	5	4	2	1
d) No provision	1	1	1	0
4. Dispute settlement				
a) Local courts	2	3	0	0
b) Courts or domestic or international arbitration	22	3	2	2
c) No provision	2	3	5	4

Source: Based on a survey of 48 national investment codes conducted by the World Bank, Legal Framework for the Treatment of Foreign Investment, volume I, Survey of Existing Instruments (Washington D.C., The World Bank Group, 1992).

1. Entry and establishment

37. Today, all countries around the world admit FDI in principle, and total prohibition of FDI no longer exists. However, no single country (even among the strongest advocates of a liberal FDI regime) grants an unrestricted right of entry to all sectors and activities. It is difficult, none the less, to make generalizations about the types of industries that remain restricted, as these vary considerably from country to country.

38. In the developed countries, some activities in the natural resources sector that had traditionally been kept in the hands of the State, have been liberalized, although many restrictions remain, for example, in the fishing, mining, oil and energy industries. The manufacturing sector is now practically open in these countries, while many of the restrictions and regulations previously maintained in the services sector are being gradually lifted. Some restrictions remain in a few but important services industries, such as telecommunications, maritime, land and air transport, media activities and professional services (UNCTC, 1993; OECD, 1992).

39. In the developing world, the picture is more complex and diverse. The liberalization process of the 1980s has been selective, with a tendency to focus mainly on export-oriented manufacturing industries or projects involving advanced technology. Gradually, other manufacturing industries have been opened to FDI. Certain services industries traditionally closed or restricted to FDI have started to be liberalized, although, in general, the liberalization of services has not yet reached the levels typically found in developed countries, other than within regional integration schemes. More recently, certain restrictions in the natural resources sector have been lifted, even by privatizing what had been nationalized in previous decades (UNCTC, 1992a, 1992b; 1993; UNCTAD, 1994a, 1994b).

40. It is likely that the process of liberalization initiated in all sectors will continue in the future, supported by regional and multilateral initiatives aimed at achieving that goal. For example, the adoption of the European Energy Charter currently under negotiation could have major implications for the liberalization of the energy industry in Eastern Europe. Similarly, the recently concluded agreement on trade in services within the framework of the Uruguay Round of multilateral trade negotiations will provide impetus for the removal of additional restrictions in services industries, both in developed and developing countries (GATT secretariat, 1993).

2. Ownership and control

41. Compulsory majority and minority shareholdings have lost importance over the years as a means of restricting the entry of FDI. Most developing countries that used to impose such restrictions across the board now generally allow full ownership of foreign affiliates. However, ownership limitations continue to be used as a means of restricting FDI in specific industries and activities. Developed countries sometimes use restrictions in shareholding to limit access in privatization cases or in services industries (e.g., telecommunication, broadcasting, air transport) that have not yet been completely liberalized.

Moreover, some countries, both developed and developing, continue to impose limitations on the number of foreign firms allowed in certain industries such as banking, financial, professional, telecommunications, air transport and broadcasting.

42. Restrictions affecting the structure of control in foreign affiliates continue to be used in developing countries, and less frequently in developed countries, particularly in large investments in industries or activities of crucial strategic importance for the local economy. They are also in use in cases of privatization of public monopolies in which the State continues to play a role. A common instrument of internal control is the granting of golden shares to the host Government; this, among other things, permits it to appoint a certain number of members on the boards of directors and to intervene if a foreign investor captures more than a certain percentage of the investment. In addition, it is still not uncommon for developing countries to impose restrictions on the national composition of management, or to require local participation in the management of a foreign affiliate.

43. Another modality of FDI restrictions that was used in the past by developing countries (in particular by the Andean countries, as part of the common regime for FDI promulgated by the Andean Pact) consisted of "fade-out" requirements, whereby foreign investors were obliged to pass on the investment to national hands over a period of time (normally 10 to 15 years). With the change of the Andean Pact regulations on this point, "fade-out" requirements have virtually disappeared (UNCTAD, 1994b).

3. Operational restrictions

44. Restrictions on the employment of aliens are ubiquitous, most often on the basis of general legislation on immigration and employment rather than of laws relating to FDI. The latter deal in many instances with issues that specifically affect FDI, in particular the employment of professional and managerial personnel. Employment matters may become the subject of performance requirements, when developing countries require employment and training of local labour as a condition for allowing an investment or for granting special treatment (tax incentives) to it.

45. Performance requirements have shown in recent years a tendency to loosen their compulsory character and, instead, tend to be related to positive inducements. While statistical data from the late 1970s and early 1980s showed a widespread use of various types of performance requirements, indicating a growing emphasis on domestic value added and exports, some authors have noted more recently that developing countries have been relaxing some performance requirements during the 1980s (UNCTC and UNCTAD, 1991). 12/ Performance requirements can also be found in private agreements with specific investors.

46. There are, of course, other types of operational restrictions. One of them, important for many companies, concerns the ability of foreign affiliates to raise capital locally. Restrictions of this sort are now being lifted in a number of countries, at times in connection with the promotion of emerging capital markets.

4. Authorization and reporting

47. While in a considerable number of countries the laws may not impose explicit restrictions on FDI, Governments may continue to exercise significant controls over its entry by imposing screening procedures. Such procedures have been abolished in most developed countries and tend to disappear gradually in developing countries as well, being replaced by registration or notification. Yet, some kind of screening continues in many instances, where authorization or special permission is still required for entry into specific industries or types of activities, or for investments above certain amounts, or where the Government reserves its right to deny entry to FDI on grounds of national security (UNCTC, 1992a, 1992b, 1993; UNCTAD, 1994a, 1994b).

5. Investment incentives

48. Countries, both developed and developing, use a wide variety of incentives to promote their policy objectives. In the main, incentive programmes do not discriminate in favour of foreign investors. When they do, it is to attract them to certain industries, or they are linked to export promotion, structural adaptation, training or the introduction of advanced technology. Among the many types of incentives schemes, industrial estates, special economic zones, bonded areas, export-processing zones and, more recently, science parks have attracted considerable attention. In addition, a broad variety of financial incentives, particularly in the form of subsidized sites, other infrastructure facilitation and business services, are offered by regional and city authorities to encourage regional development. In recent years, countries have become more selective and focused in their granting of incentives that are often made conditional upon certain performance requirements being fulfilled by the investor. This responds to the general perception that incentives are only a second-best solution to attract investment, and that, as host countries compete with each other in the granting of incentives, these tend to cancel each other out and simply raise the rents to private investors without increasing the social benefits of the projects for the countries concerned.

49. As already noted, many countries that otherwise do not require authorization for entry have established various criteria and requirements as prerequisites for the grant of tax concession and other kinds of privileged fiscal regimes and other incentives. The administration of investment incentives involves by necessity screening on the part of the competent authorities. Such procedures can be painless in the ideal case of a perfectly functioning civil service but in actual cases they can constitute problems for the foreign investor. A number of countries are moving away from special incentives towards reformulating their overall fiscal regimes.

6. National treatment

50. Most developed countries grant in principle national treatment unilaterally to all potential foreign investors as part of their constitutions and basic laws (including civil and commercial codes) (OECD, 1991 and 1993). In addition, many of them have undertaken international commitments in that respect in the context

of regional integration schemes. Moreover, in the context of regional agreements and bilateral investment treaties with developing countries, many developed countries have adopted reciprocal obligations to grant national treatment (table 1). As a result, there is now a broad network of international commitments on national treatment covering a large proportion of developed and developing regions.

51. According to a recent survey of 48 investment codes adopted by developing countries conducted by the World Bank (World Bank, 1992; UNCTC, 1988 and 1992b) (table 2), the overwhelming majority of the developing countries surveyed have adopted provisions to the effect that there shall be no discrimination against FDI as compared with local investors. At the same time, many of the countries that adopt this principle have favoured a definition of national treatment as being treatment similar or equal to that given to local investors, thus excluding the possibility of granting more favourable treatment to FDI.

52. When a country commits itself to grant national treatment to FDI, it is normally assumed that the principle applies to all aspects of the operations of a foreign investment in the host country, unless specifically indicated by way of exceptions. The categories of exceptions may vary from country to country but tend to be largely similar to those imposed on entry and establishment (e.g., national security, the protection of vital political and social interests, the furtherance of development objectives) (box 2).

Box 2. Restrictive measures affecting the national treatment standard in OECD countries

Recent surveys on the application of the national treatment standard among the OECD countries have identified a number of areas where discrimination between foreign affiliates and national enterprises tends to be particularly significant. a/ These include,

* Investment by established foreign-controlled enterprises. Limitations on reinvestment are found in a number of developed countries, particularly in the natural resources and services areas. The most common are those affecting the scope of business operations and the volume and range of production. In the area of banking and financial services, limitations on the scope of business operations for established foreign affiliates are still being used.

* Official aids and subsidies. While the general approach in developed countries is not to discriminate between foreign and local investors regarding official aids and subsidies, at times these are granted on a discriminatory basis in order to promote local industries and activities, for example in the areas of subsidies by local authorities and those relating to research and development. The opposite is also true sometimes: foreign investors may be given advantages or facilities not available to national enterprises, typically as a means to encourage them to invest at the particular location.

* Taxation is another area in which the treatment of foreign affiliates and branches is often less favourable than that accorded to national enterprises in the same situations. In particular, developed countries tend to discriminate in the treatment of dividends paid abroad, the differences in tax rates applied to local enterprises, and the tax treatment of branches of foreign-controlled enterprises.

* Government procurement. Governments often give preferences to national firms in bidding on public procurement contracts. Pertinent examples of policies pursued by developed countries include outright prohibition of foreign sourcing, formal criteria for allowing foreign sourcing, and procedures favouring procurement from national firms. In addition to the distinction between national and foreign firms, rules of origin might qualify as foreign the products of foreign-controlled enterprises established in the host country, thus excluding them for public procurement purposes. Most developed countries still continue to reserve government procurement to nationally owned firms.

* Access to local credit by foreign-controlled firms. Foreign affiliates may be prevented from borrowing or raising capital in the host country and thus need to rely on foreign finance for their capital needs. Such restrictions may respond to a host country's need to avoid shortages of capital or foreign exchange, or to prudential considerations. These limitations are imposed by developed countries, although their use has diminished significantly during the past decade.

* Access of foreign-controlled firms to communication and distribution networks may be restricted by government measures or discriminatory practices, since many telecommunications, postal, computer networks or similar services are public monopolies. Such practices tend to be less frequent in developed countries today.

a/ OECD, National Treatment for Foreign Controlled Enterprises (Paris, OECD, 1993).

7. Transparency of laws, regulations and administrative practices

53. In recent years, Governments have made considerable efforts to publicize and disseminate information on their policy, normative and administrative frameworks relating to FDI and to ensure that this information reaches potential foreign investors. Such efforts are usually part of broader promotion activities to attract FDI. They seek to facilitate the understanding of the countries' FDI regime by presenting the key features of such regimes in a simple and concise manner. Governments that screen foreign investors through authorization procedures have also sought to improve the transparency and efficiency of such procedures by establishing "one-stop shops" dealing with all the approval requirements. Some of these agencies are charged with both screening and promoting FDI and, thus, furnish foreign investors with relevant

information to assist them in their establishment and operations. Frequently, however, the impact of these one-stop shops is negligible.

54. Transparency can be expected to be increased as part of the implementation of the General Agreement on Trade in Services and the agreement on Trade-related Investment Incentives, negotiated as part of the Uruguay Round. These commitments underscore the fact that transparency of regulations is an essential part of the liberalization of FDI policies. Other international organizations, such as the International Monetary Fund, the World Bank, the OECD and various regional integration schemes, routinely collect information regarding various FDI policies and measures. However, a mechanism for international transparency in all areas of FDI and for all countries does not exist, reflecting the fact that FDI is not governed by an international framework of rules that would necessitate international notification and reporting as a means of ensuring that the signatories adhere to their commitments.

8. Transfer of funds

55. While exchange controls are far less prevalent now than they were 40 years ago, they are still present today all over the world, although their precise form and the extent vary widely (tables 1, 2 and 3).

56. At present, all developed countries allow, in principle, the free repatriation of the foreign capital invested. Most restrictions on transfers of profits and dividends have also been abolished in most developed countries (OECD, 1992 and 1993). With respect to the developing countries, two opposite trends concerning exchange regulations took place during the 1980s. On the one hand, developing countries faced with debt-servicing problems increased their controls in order to stem foreign exchange outflows. On the other hand, most surveys (UNCTC and UNCTAD, 1991) noted a general relaxation of foreign exchange controls, as developing countries engaged in intense competition for FDI. According, however, to a recent survey of 48 developing countries conducted by the World Bank (World Bank, 1992) (table 2), only two of these countries grant foreign investors an unrestricted transfer of payments and capital. A small number of countries requires that capital be repatriated only after a specified period of time, or in instalments. The majority of the remaining countries, including countries from all developing regions, guarantee transfers of both capital and profits in principle, while making such guarantee subject to foreign exchange regulations. Thus, an increasing number of countries have accepted in principle the commitments of Article VIII of the International Monetary Fund's Articles of Agreement to avoid restrictions on current payments, including remittances of profits (figure 2), while, at the same time, a number of these countries have continued to impose temporary restrictions on such transactions invoking the balance of payment exception authorized under the Agreement (figure 3). 13/

Table 3. Changes in the regulation of repatriation of income and capital, selected developing countries, 1988-1993

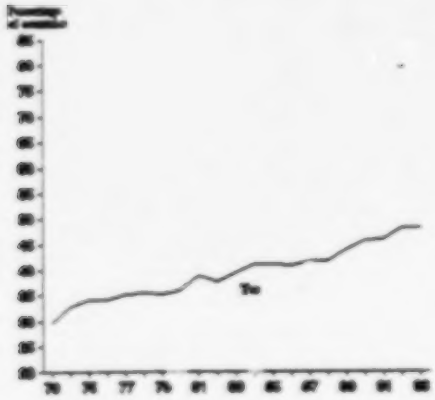
Country	Repatriation of capital and income									
	1988		1989		1991		1992		1993	
	I	C	I	C	I	C	I	C	I	C
Argentina	SR	SR	F	F	F	F	F	F	F	F
Bangladesh	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR
Brazil	F	SR	F	SR	F	F	F	F	F	F
Chile	F	SR	F	SR	F	SR	F	SR	F	SR
Colombia	SR	F	SR	F	SR	F	F	F	F	F
Costa Rica	SR	SR	SR	SR	SR	SR	SR	SR	F	F
Greece	SR	SR	SR	SR	SR	SR	SR	SR	F	SR
India	SR	SR	SR	SR	SR	SR	SR	SR	F	F
Indonesia	SR	SR	F	F	SR	SR	SR	SR	SR	SR
Jamaica	SR	SR	SR	SR	SR	SR	SR	SR	F	F
Jordan	F	F	F	F	F	F	F	F	F	F
Korea, Republic of	F	F	F	F	F	F	F	F	F	F
Malaysia	F	F	F	F	F	F	F	F	F	F
Mexico	F	F	F	F	F	F	F	F	F	F
Nigeria	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR
Pakistan	SR	SR	SR	SR	F	F	F	F	F	F
Peru	R	R	R	R	R	R	F	F	F	F
Philipines	F	F	F	F	F	F	F	F	F	F
Portugal	F	F	F	F	F	F	F	F	F	F
Sri Lanka	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR
Thailand	SR	SR	F	F	F	F	F	F	F	F
Trinidad and Tobago	SR	SR	SR	SR	SR	SR	SR	SR	F	F
Venezuela	SR	SR	SR	SR	SR	SR	SR	SR	F	F
Zimbabwe	R	R	R	R	R	R	R	R	R	R

Source: International Finance Corporation, Emerging Stock Markets Factbook (Washington D.C., IFC, 1988 through 1993).

Key:

I - Repatriation of income (dividends, interest and realized capital gains).
C - Repatriation of capital (initial capital invested).
F - Free (repatriation is done routinely).
SR - Some restrictions (typically requires some registration with or permission of Central Bank, Ministry of Finance, or an Office of Exchange Controls that may restrict the timing of exchange release).
R - Restricted.

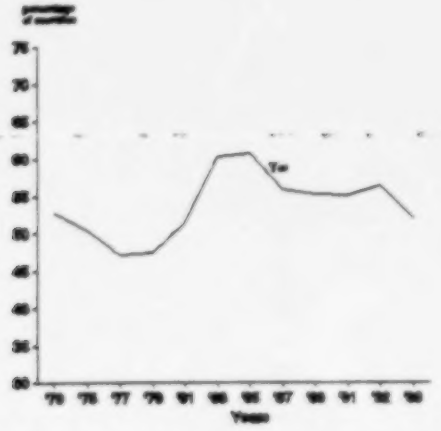
Figure 2. Countries that have undertaken commitments to avoid restrictions on remittances of earnings, a/ 1973-1993



Source: International Monetary Fund, Exchange Arrangements and Exchange Restrictions, Annual Report (Washington, D.C., IMF, 1973 through 1993).

a/ As part of the general commitments undertaken by members on the avoidance of restrictions on current transactions under article VIII of the IMF Articles of Agreement.

Figure 3. Temporary restrictions on current transactions, including repatriation of earnings, a/ 1973-1993

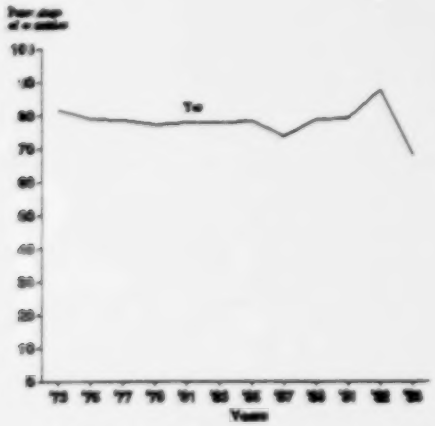


Source: International Monetary Fund, Exchange Arrangements and Exchange Restrictions, Annual Report (Washington, D.C., IMF, 1973 through 1993).

a/ Within the exceptions allowed by the IMF Agreement for balance-of-payments considerations.

57. Most countries continue to screen capital movements through direct controls administered by the monetary authority. Transfers over a given amount may require the central bank's prior approval. In the event of a balance-of-payments crisis, the central bank may even withhold permission for overseas payments for an unspecified period (figure 4). There are also various restrictions affecting short term-capital movements. In addition, many countries continue to impose taxes on the remittance of profits, dividends and capital. These fiscal instruments are meant to stimulate reinvestment of profits in the host country. But outright obligations of reinvestment of profits, which were used in the past by developing countries, seem to have been discontinued.

Figure 4. Restrictions on capital transactions, 1973-1993



Source: International Monetary Fund, Exchange Arrangements and Exchange Restrictions, Annual Report (Washington, D.C., IMF, 1973 through 1993).

9. A summary appraisal

58. The wave of liberalization measures in the 1980s and 1990s has changed considerably investment regimes in today's world. The most important changes have taken place in the following areas:

(a) The number of industries and activities closed or restricted to FDI has been considerably reduced;

(b) Compulsory joint ventures with Government or local private participation are now limited to a small number of "strategic" activities in a few countries;

(c) Fade-out requirements have virtually disappeared;

(d) The requirement of authorization for entry and establishment for all FDI has been generally eliminated and replaced by registration, mainly to facilitate the repatriation of capital and remittances of profits and other current payments. In some industries (e.g., banking), of course, authorization requirements remain, often in the context of such requirements for both foreign and domestic firms;

(e) Certain performance requirements have now been prohibited, while others have become more focused and tend to be voluntary, required mainly in return for incentives;

(f) While exchange controls are still in effect in many countries, there are indications that they are administered in a more liberal fashion with respect to the remittances of profits and the repatriation of capital of registered investments;

(g) The principles of non-discrimination and national treatment are gaining acceptance and are in fact recognized in the basic laws of many countries or as part of international commitments;

(h) Internationally acceptable standards of legal protection for foreign investors, particularly in the areas of expropriation, state contracts and settlement of disputes, are now guaranteed by the State in many countries, as part of their national legislation and increasingly through international commitments;

(i) Many Governments have taken steps to publicize and disseminate their laws and regulations on FDI, increasing in this manner the transparency of their regulatory frameworks;

(j) A number of countries have adopted or are strengthening their antitrust laws, and health, safety, consumer and environmental standards, and have established mechanisms to supervise international mergers and acquisitions, stock exchanges and financial markets.

59. A more accurate and detailed picture of the status of the liberalization process would have to be reached through a sectoral analysis of its operation.

While certain broad uniformities obtain, the limits, the needs and the possibilities of liberalization differ in each of the major economic sectors. 14/

III. BEYOND LIBERALIZATION

60. The basic elements of the liberalization process reviewed above, namely, the elimination of restrictions and discrimination, adherence to certain positive standards and the establishment of controls and prudential supervision to ensure the proper functioning of the market, are central, immediate and direct aspects of the policy and normative framework for FDI and TNC operations. Yet, the broader context within which foreign affiliates operate inside a host country is also relevant and, as the liberalization process progresses, becomes increasingly visible. Certain aspects of the internal normative framework are essential to give meaning and effect to that process. This applies, in particular, to the broader regulatory and administrative framework and the investment climate in general.

(a) The effectiveness of the liberalization process, including the operation of controls to ensure its proper functioning, depends on the existence of a reasonably comprehensive legal framework for business activities in general, including, for example, appropriate legislation on companies, industrial relations and insolvency. In fact, a properly functioning legal order, including well functioning courts, is required to provide predictability and certainty, including, for instance, respect for such basic principles as due process of law. Furthermore, reasonably well functioning administrative infrastructures are necessary to ensure the effective implementation of the legal framework within which business operates. In the absence of a reasonably complete framework and legal order, a case-by-case treatment of investments and enterprises would be necessary. In a country lacking adequate legislation on the exploitation of natural resources, for instance, each "concession" to a prospective investor would be fashioned on the basis of the State's needs at the moment, short-run conditions in the relevant market, the investor's ability to persuade local officials and other factors. The result may be a situation in which different investors in the same industry operate under different rules negotiated by contract. Subsequent investors typically try to improve on previous ones. The experience in many developing countries rich in natural resources has shown clearly the dangers of such a situation. Regardless of intentions, or fairness of approach, case-by-case treatment does not provide adequate predictability to investors and has in itself the potential for arbitrary action and for restrictions of various kinds. In such a situation, moreover, such fundamental facets of a liberalized regime as the grant of national treatment can have no precise meaning and function. Liberalization is a fragile process that needs the support of a sturdy legal framework to survive;

(b) Furthermore, this is only part of what constitutes a good investment climate. Of course, certain issues like political and economic stability may not be under a government's immediate control. Similarly, the establishment of a sound macroeconomic framework, the upgrading of a country's human resources and the strengthening of its physical infrastructure may require some time. But there are a number of measures a government can take, where appropriate, with an

immediate effect on the investment climate. For example, entering into bilateral or multilateral commitments to guarantee foreign investors against non-commercial risks may boost investors' confidence. Also, a variety of promotional efforts can be undertaken to attract investment. Apart from their intrinsic value, promotion measures send positive signs of the "good will" of the host country towards foreign investors and, therefore, constitute important ingredients of a favourable investment climate. The same effects can be obtained from a positive attitude of the governments to the private sector (both domestic and foreign) which, among other things, can find its expression in privatization programmes.

61. Overall, the liberalization of FDI regimes and the provision of a favourable investment climate do not imply a weakening of the role of government, but rather a redefinition of some of its functions and the strengthening of others. In particular, the processes of reducing restrictions and establishing positive standards occur simultaneously with the introduction or strengthening of controls aimed at ensuring the proper functioning of markets. Finally, and recalling the relative character of liberalization and the fact that there are more and less liberalized regimes, it must be stressed that a description or even an analysis of the liberalization process cannot involve a quest for perfection. It would be difficult to define in clear terms what constitutes a perfect investment regime, in terms of liberalization, even from the viewpoint of a single investor, and even more so if one had to take into account the interests of other investors, domestic as well as foreign, and the long-term interests of the countries concerned. The liberalization process is a policy process; and, like all such processes, it involves difficult choices between desirable outcomes and trade-offs between objectives. Any discussion must accept that it necessarily involves trends and patterns, and moves in areas of approximation and uncertainty.

IV. CONCLUSIONS

62. While the process of liberalization has led to a certain convergence of the characteristics of FDI regimes, numerous - and at times considerable - differences, of course, remain. With the increasing internationalization of the domestic policy agenda (Ostry, 1992) due to the greater integration of the world economy at the level of production, these differences assume greater importance than in the past. Investment policies in one country can and do influence events in other countries and, in any case, the experiences gained with FDI in one country are of potential interest to decision makers in other countries. Exchanges of information on FDI become, therefore, more important than they were in the past.

63. The most important basic effect of such exchanges of information is to increase transparency. Increased transparency has a number of benefits for the world economy, home and host countries and for TNCs. Given the interlinkages between FDI, trade and technology, FDI matters are increasingly becoming part of international discussions on trade and technology, as witnessed, for instance, by the negotiations of the Uruguay Round and NAFTA; exchanges of experiences can help policy makers to deal more effectively with these interrelationships.

64. For Governments, the exchange of information about the normative frameworks that govern FDI in their countries is beneficial because it allows them to learn from the experiences - and especially best practices - elsewhere. At the same time, greater transparency of the investment framework facilitates the decision-making process of TNCs, especially small- and medium-size enterprises and those from developing countries that have limited in-house capacities to obtain relevant information.

65. The effectiveness of the exchanges that have already been undertaken could benefit from more structured preparations and more systematic discussions and the participation of interested private sectors. The Commission may wish to consider whether this is, indeed, an objective worthwhile pursuing and, if so, how it could be done most effectively.

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Notes

1/ See UNCTAD, Report of the Ad-Hoc Working Group on Comparative Experiences with Privatization on its Third Session (TD/B/40(2)/5).

2/ See UNCTAD, Report of the Ad-Hoc Working Group on the Interrelationship between Investment and Technology Transfer on its Second Session (TD/B/40(2)/10).

3/ See "Case study submitted by the Netherlands" (TD/B/WG.1/Misc.3); "Case study submitted by the Republic of Korea" (TD/B/WG.1/Misc.3/Add.2); and "Case study submitted by the United States of America" (TD/B/WG.1/Misc.3/Add.7).

4/ See "Case study submitted by Brazil" (TD/B/WG.1/Misc.3/Add.6); "Case study submitted by China" (TD/B/WG.1/Misc.3/Add.5); "Case study submitted by India" (TD/B/WG.1/Misc.3/Add.3); "Case study submitted by Mexico" (TD/B/WG.1/Misc.3/Add.1); "Case study submitted by Morocco" (TD/B/WG.1/Misc.3/Add.8); "Case study submitted by Myanmar" (TD/B/WG.1/Misc.3/Add.10); "Case study submitted by Nigeria" (TD/B/WG.1/Misc.3/Add.9); and "Case study submitted by the Philippines" (TD/B/WG.1/Misc.3/Add.4).

5/ For more details, see the reports of the Ad Hoc Working Group on Investment and Financial Flows, first session (TD/B/39(2)/6); second session (TD/B/40(1)/12); and third session (TD/B/40(2)/12).

6/ See UNCTAD, "Host country policies and measures to promote foreign investment: a synthesis of eight case studies", TD/B/WG.1/10, 25 October 1993.

7/ Foreign direct investment - the focus of this report - is defined as investment, including both equity and non-equity arrangements, that involves a long-term relationship reflecting a lasting interest of a resident entity in one economy (direct investor) in an entity resident in an economy other than that of the investor. The direct investor's purpose is to exert a significant degree of influence over the management of the enterprise resident in the other economy. A foreign-resident affiliate (thereafter "foreign-affiliate") of a TNC may be an enterprise incorporated in the host country (a subsidiary or associate company) or an unincorporated branch. See the definitions of FDI prepared by the OECD and the IMF; OECD, Detailed Benchmark Definition, Report Prepared by the Group of Financial Statisticians at the Request of the Committee on International Investment and Multinational Enterprises (Paris, OECD, 2nd Edition, 1992); IMF, Balance of Payment manual, Fifth Edition (Washington, D.C., IMF, 1993).

8/ It should be noted, however, that many countries started the liberalization process in the context of bilateral investment treaties and regional schemes; indeed, it is within the latter commitments that the highest levels of liberalization have been achieved. The liberalization process discussed here involves national measures as well as bilateral, regional and (when applicable) muitilateral instruments.

9/ For a discussion of the relationships between the concepts of efficiency, development and liberalization, see UNCTAD, Programme on Transnational Corporations, and The World Bank, Liberalising International Transactions in Services: A Handbook (New York, United Nations, 1994).

10/ For an in-depth analysis of the various elements involved in the definition of the standard of national treatment see, UNCTC, Key Concepts in International Investment Arrangements and Their Relevance to Negotiations on International Transactions in Services, UNCTC Current Studies Series, Series A, No. 13 (United Nations publication, Sales No. E.90.II.A.3).

11/ See note 4.

12/ T. Andersson (Foreign Direct Investment in Competing Host Countries, A Study of Taxation and Nationalization, 1989) and St. Globerman ("Government policies towards foreign direct investment: has a new era dawned?", The Colombia Journal of World Business, 23 (1988), pp. 47-78), for instance, found some evidence of general relaxation of host country performance requirements already in the early 1980s.

13/ Article VIII of the International Monetary Fund's Articles of Agreement prescribes general obligations for Members with respect of the avoidance of restrictions on current payments, including remittances of profits, avoidance of discriminatory currency practices, convertibility of foreign-held balances, furnishing of information, consultation between members regarding existing international agreements, and collaboration regarding policies on reserve assets.

14/ For a detailed study of the characteristics of liberalization in the services sector, see UNCTAD, Programme on Transnational Corporations, and World Bank, Liberalizing International Transactions in Services, op. cit.